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Competitive and Monopoly Price

BY
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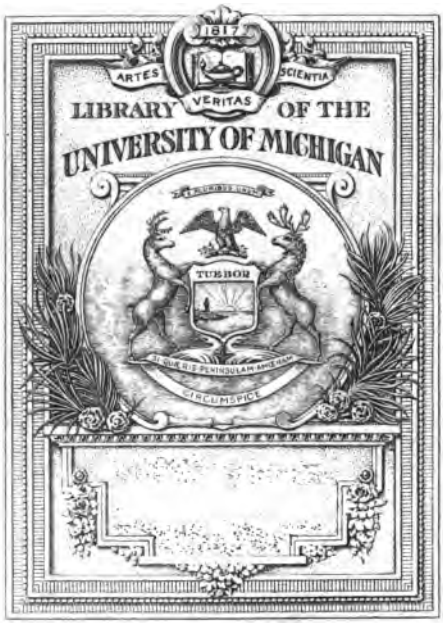
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University of Cincinnati Studies

Competitive and Monopoly Price

A criticism of current theory with special reference to its bearing upon the trust problem

704

By

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Competitive and Monopoly Price

I

THE BASIS OF THE PRESENT TRUST POLICY

THE present trust policy of the United States is an attempt to destroy monopoly and thereby leave the field to competitive industry. This policy finds expression in the anti-trust laws of the United States and of the several States; in their judicial interpretation; in the demand that these laws be more rigorously enforced; and in various proposals to amend the laws so as the more surely to accomplish their purpose, wherever in their present form they are inadequate to the annihilation of monopoly.

Many illustrations might be given to exemplify this policy. One will, however, suffice for the present purpose. The Anti-Trust law of the United States declares that:

> "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal."
>
> "Every person who shall monopolize, or attempt to monopolize, or combine or conspire

> with any other person or persons to monopolize, any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor, . . ."[1]

This law has been the subject of numerous court decisions, including several by the Supreme Court of the United States. Among the most important cases to reach this high tribunal was the one known as the *Northern Securities* case, which was decided in 1903. The opinion, affirming the decree of the circuit court against the Northern Securities Company, was prepared by the late Mr. Justice Harlan. In this opinion, after extended reference to previous decisions of the Court, several propositions were stated as deducible from those decisions. Among these propositions are the following:

> "That Congress has the power to establish rules by which interstate and international commerce shall be governed, and, by the Anti-Trust Act, has prescribed the *rule of free competition* among those engaged in such commerce."
>
> "That the *natural effect of competition is to increase commerce,* and an agreement whose direct effect is to prevent this play of competition restrains instead of promotes trade and commerce."
>
> "That to vitiate a combination, such as the act of Congress condemns, it need not be shown that the combination, in fact, results or will result in a total suppression of trade or in a *complete monopoly,* but it is only essential to show that by its necessary operation, it tends to restrain interstate or international trade or commerce or *tends to create a monopoly* in such trade or commerce and to deprive the public of the *advantages that flow from free competition.*"[2]

---

[1] 26 Stat. at Large, 209, chap. 647, U. S. Comp. Stat. 1901, p. 3200.

[2] U. S. Reports, 193, pages 331, 332. Not italicized in the original.

Throughout the opinion, numerous references are made to the "natural laws of competition," to the advantages arising therefrom, and to the purpose of the Act to secure the operation of those laws. Subsequent decisions containing further interpretations of the Act have not modified this fundamental attitude towards competition and monopoly. The so-called "rule of reason," recently applied to the enforcement of the law, has gone no further than to recognize that not all suppression of competition is necessarily in restraint of trade. The intent of the law remains, as before, to prevent monopoly and to secure free competition.

Moreover, in this intent, the Anti-Trust law voices correctly public opinion. Although there is widespread dissatisfaction with the results that have been attained under it, popular confidence in its fundamental purpose continues undiminished.

An explanation of this general attitude condemning monopoly and approving competition is to be found in an intuitive belief in the doctrine of "fair price."

The idea that some prices are fair and others unfair is practically universal. This idea has existed for centuries, perhaps as long as buying and selling themselves have existed. During the Middle Ages it was known as the doctrine of "just price," an admirable description of which is found in Professor W. J. Ashley's "English Economic History." At that time it was taught that "in any particular country or district there is for every article, at any particular time, some one just price: that prices, accordingly, should not vary with momentary supply and demand, with individual caprice, or skill in the chaffering of the market. It is the moral duty of buyer and seller to try to arrive, as nearly as possible, at this just price."[8] Moreover, "as experience showed

[8] Vol. I, p. 146.

that individuals could not be trusted thus to admit the real value of things, it followed that it was the duty of the proper authorities of State, town, or guild to step in and determine what the just and reasonable price really was."[4]

The application of such a principle to actual business transactions necessitated a standard by which to determine whether the prices at which commodities and services were offered for sale were just or unjust. Such a standard was found for the producer of that time, not in "what would enable him to make a gain," but in "what would permit him to live a decent life according to the standard of comfort which public opinion recognized as appropriate to his class."[5] Moreover, it may be noted in passing, this standard was not ill-adapted to the conditions then prevailing, when business intercourse was on a small scale, the market for most articles was a limited one, and the consumer and producer as a rule dealt directly with each other.

With the passing of years, new industrial conditions developed to which old ideas and old policies were no longer suited. But there remained and still remains the basic idea of fair price. There has come, however, a new standard by which to determine fairness and a new view as to the proper method for securing fairness.

It is, perhaps, too much to affirm that the present standard of fair price has been definitely formulated. Nor it is intended here to enter upon a full discussion of this subject; though, in view of the controversy over "earned" and "unearned" increments and of the increasing tendency to call in the aid of public authority to secure reasonable charges, there is developing an urgent need for a thorough analysis of the basis of fairness with a view to arriving at a reasonable standard.

[4] *Ibid.* 140. [5] *Ibid.* 138.

In general, it is probably correct to say that in the efforts to prevent unfair prices at the present time, the test applied is gain or, as it is commonly called, profits. A fair price is one which yields fair profits. Just what are fair profits in any particular case is not easy to determine, but it is certain that the concept of fair profits as a test of fair prices does not mean a definite, universally applicable per cent of some arbitrarily selected base. Fair profits mean a fair return for those engaged in business, due account being taken of the character of the business, the capital required, the risks involved, and the ability demanded of those who become responsible for the initiation and conduct of business.

The absence of a definitely formulated standard for determining fairness is not a mere accident. It is due to the prevailing view as to the method by which fairness is to be secured—a method under which the question of what is fair may be left to take care of itself; for fairness, it is believed, will follow as a matter of course from the method of securing it. That method is free competition. Whereas, formerly public authority exercised directly upon price was relied upon to insure justice, to-day the same end is sought by procuring the unimpeded operation of competition.

True, it has come to be recognized that there is a field of activity in which competition is not effective. Such, for example, is the case with telephone, lighting, and other similar industries. Here Government regulation is acccepted as essential. But so far as the broad field of general industry is concerned, public opinion still holds to the idea that free competition is society's safeguard against injustice, and that public authority is needed here, if at all, only to assist in securing free competition. Competitive price is fair; monopoly price is unfair.

To this view, entertained by society in general, exemplified by the anti-trust laws above mentioned, economists lend the weight of their authority. It must suffice for the present discussion to cite but one example of the teaching of current economics, but it is a typical one, taken from the latest edition of the "Outlines of Economics," by Professor Richard T. Ely and collaborators. Speaking of prices under competition, it is said that "if we include the value of the business man's services among the expenses of production," "the prices received for the products of any particular business" tend to equal "the expenses of producing them."[6]

Later, in discussing just price, it is said:

> "The competitive system is to-day so thoroughly accepted as the 'natural' economic order, that there is, as we have previously noted, *a deep-seated conviction that normal competitive prices (measured by the expenses of production) are natural and just prices.*[7] This conviction is, however, brought face to face with the fact of the growth of a large industrial field in which monopoly, rather than competition, rules. The question of just price is again a live issue—as it was before the growth of the competitive system. Public authority is frequently invoked to insure that the prices fixed by holders of municipal franches and other monopolists are just and reasonable. *The chief fundamental test which our courts are able to apply to the reasonableness of any particular price is its conformity to what the price would have been under competitive conditions.*[7] Thus it is often asked if a particular monopoly charge gives a more than normal return upon the capital invested. The determination of what the expense of producing a particular commodity or service really is, is often a difficult, or even impossible, task

[6] p. 171. [7] Not italicized in the original.

> (the distinction between constant and variable expenses being frequently a stumbling-block), but, given the general acceptance of the competitive system, it is hard to see what other standard could be used."[8]

Few, if any, are satisfied with the results of our present anti-trust policy. Some are calling for more stringent enforcement of existing laws; others for amendments to those laws which shall remove all possible avenues of escape, especially those believed to be afforded by the latest Supreme Court decisions; while still others are asking for such a modification of our anti-trust policy as shall permit a distinction between good and bad trusts.

What, meanwhile, is to be said of the current economic doctrine of competitive and monopoly price,—a doctrine which is at the root of the whole matter?

---

[8] pp. 180, 181. In an earlier part of the treatise (p. 159) the reader is warned against the error of assuming "that competitive prices are in some way 'natural' and right prices," yet when the author himself proceeds to indicate a practical standard for determining the "reasonableness of any particular price," he finds it "hard to see what other standard could be used" than "its conformity to what the price would have been under competitive conditions."

II

THE CURRENT THEORY OF PRICE

As it is the purpose of this paper to analyze the current theory of price with a view to judging its validity, it is necessary to state in this connection just what this theory is; though, as the subject is fully set forth in numerous available treatises on economics, only its salient features need be described here.[1]

Current theory recognizes two sorts of price, designated respectively competitive price and monopoly price. Corresponding to these are two classes of business, competitive industries and monopolies.

Competitive price exists when competition is free, and it equals cost of production. By cost of production is meant the actual expense of producing plus what may be called normal profits. To avoid misunderstanding, this may be called social cost of production. To the individual, cost of production means of course the amount which he must pay for raw materials, wages, interest on capital, and such other outlays as are incident to the production and sale of goods. These expenses

[1] The illustrations of current theory in the following description are taken from the *Outlines of Economics*, by Richard T. Ely, revised and enlarged by the author and Thomas S. Adams, Max O. Lorenz and Allyn A. Young, published by The Macmillan Company, New York, 1909. Essentially similar illustrations are afforded by all standard treatises on Economics. See, for example, Seligman's *Principles of Economics*, Part III, Book I. Value: General Principles; and Seager's *Introduction to Economics*, Chap. V, Value and Price, and Chap. XI, Distribution: Monopoly Profits.

are deducted from the amount received from sales, and the difference constitutes his profits. But, viewed from the standpoint of the consumer, profits are the payment for the services of the one who provides the business ability without which commodities can no more be produced than without labor, for which wages are paid. From the standpoint of society, then, it is proper to include at least normal profits as a part of cost of production.

Just what normal profits are, as was pointed out above,[2] can not be stated precisely as a certain per-cent or as a fixed amount. Yet that such a thing as normal profits exists as a feature of current thought, is evidenced by the not infrequent reference to profits in some transactions as abnormal. Normal profits will of course vary with the quality of business ability required in various undertakings, the risk involved, and other attending conditions,—in brief, with the character of the business. A sufficiently accurate description of normal profits is afforded by the statement that profits may be considered normal in any industry when they afford no special or extra inducement to enter the business or to leave it.

Competitive price, then, tends to equal social cost of production.

> "If it were always an easy matter for business men to change their interests and their energies from one line of production to another, and if capital and labor could likewise be freely transferred from one undertaking to another, it is hard to see how profits in any one competitive business could be for any length of time much higher than in other competitive businesses. Managerial ability, labor, and capital would gravitate always toward those employments

[2] p. 9.

> which promised the greatest profits. The effect would be a continual tendency toward equality of advantage in different lines of business. This does not mean necessarily an equality of profits as between individuals in any given lines of business, for the amount of profits depends largely upon the skill and enterprise of the individual business man. . . . Purely competitive profits, under conditions of absolute 'fluidity' of business ability, of labor, and of capital, would thus tend to adjust themselves according to the ability of the individual business man; . . . If we include the value of the business man's services among the expenses of production, we may, obviously, state the tendency which we have described as a tendency toward the equality of the prices received for the products of any particular business and the expenses of producing them."[8]

The proposition that price equals social cost of production assumes a condition of free competition, and it is important to note what is meant by such a condition. From the above description of the nature and tendency of competitive price, it will be seen that competition is considered free when capital, labor, and business ability can move with perfect freedom from one industry to another. This is often called a condition of perfect fluidity, and the designation is a fortunate one, for there is involved an analogy to the tendency of water to seek the same level in several different receptacles which are so connected that the water can pass freely from one to another.

It would, however, be a mistake to suppose that those who accept the doctrine of price here described believe that productive agencies are or ever can be perfectly fluid or that competition is, even under so-called competitive conditions, ever absolutely free. On the con-

[8] Ely, pp. 170, 171.

trary, it is recognized that co-operation and custom modify the working of competition, while at times the state, in order to raise the plane of competition, "sets limits to the rivalry," which is the essence of competition, as, for example, when it regulates the labor of women and children, requires safety appliances and sanitary conditions, limits the right of contract in the case of injury, and so forth.[4]

Nor is perfect fluidity necessary to the existence of competitive price, for there is always some free capital, free labor, and free business ability seeking a field of operation, and at the same time the capital, labor, and business ability now employed tend to wear out and disappear. The new will seek the fields offering highest returns, while, as the old disappears, it will not be renewed in those industries which yield less than normal returns.

> "Managerial ability, labor, and capital are all specialized to a greater or less extent, so that they can not be changed from one employment to another without loss of efficiency. But it is not necessary for the validity of our analysis that *all* managerial ability, *all* labor, and *all* capital should be fluid enough to change from industry to industry economically. There are always a certain number of business men who are anxiously watching for the most inviting business opportunities; there is always a certain amount of labor awaiting the most remunerative employment, and there is always a certain amount of money awaiting investment in those forms of capital goods which produce the greatest value. These facts are enough to give substantial truth to the statement that in any competitive industry the price of the commodity produced tends to equal the cost of producing it."[5]

[4] Ely, p. 26, *et seq.* [5] Ely, pp. 171, 172.

In sharp contrast to competitive price is monopoly price, or the price of a commodity produced under conditions of monopoly. While under competition price is fixed at social cost of production, under monopoly price is fixed at that point which will yield the largest net returns. As has been seen, social cost of production means cost to the individual producer plus a normal profit to him. So by way of emphasizing the contrast between the two sorts of price, it may be said that competitive price is determined by normal profits, monopoly price by largest profits.

In deciding at what price to offer his goods for sale, the monopolist proceeds upon the well-known tendency for sales to decrease when prices increase and for sales to increase when prices decrease. Net returns are the product of two factors: the profit on a unit of sales, such as a bushel of wheat, a pair of shoes, etc., and the number of units sold. When, therefore, a monopolist seeks to increase his total profits by increasing the price of his commodity, he must take into account the fact that such an increase in price may be expected to result in a decrease in sales, and this in the ultimate outcome may result in decreasing the sum total of his profits. On the other hand, although lowering the price of his commodity will probably lead to larger sales, the increase in profits that might be expected from such increase in sales may be more than offset by the decreased rate of profit per unit. At some point the relation between rate of profit and extent of sales will be such as to yield the largest total profits, and, having a monopoly, he will, so far as his judgment of conditions enables him to do so, fix the price at that point.

Such, in brief, is the process by which monopoly price is determined. A full description of monopoly price

would necessitate some modification of this statement. For example, there may be more than one price that would yield the same maximum of net returns. But the fundamental principle involved, i. e., that monopoly price is determined by largest profits, would still be valid.

The following table, taken from Professor Ely's "Outlines of Economics,"[6] will illustrate the working of these principles:

PRICE PER UNIT	NUMBER OF SALES	TOTAL EARNINGS	VARIABLE EXPENSES PER UNIT	TOTAL VARIABLE EXPENSES	FIXED EXPENSES	TOTAL EXPENSES	NET REVENUE
$0.10	600,000	$60,000	$0.03	$18,000	$50,000	$68,000	—$8,000
.09	800,000	72,000	.03	24,000	50,000	74,000	— 2,000
.08	1,200,000	96,000	.03	36,000	50,000	86,000	+10,000
.07	1,800,000	126,000	.03	54,000	50,000	104,000	+22,000
.06	2,500,000	150,000	.03	75,000	50,000	125,000	+25,000
.05	3,500,000	175,000	.03	100,000	50,000	155,000	+20,000
.04	5,500,000	220,000	.03	165,000	50,000	215,000	+ 5,000

Commenting upon this illustration, the author says:

> "Study of the table will show why, in the case assumed here, the monopoly price will stand at six cents. Competition, if it were present, would keep on increasing the supply as long as normal profit could be obtained. In our illustration the lowest price at which production could be carried on so as just to secure a profit above the expenses of production would be four cents; and four cents would therefore be the competitive price. . . . But since the mo-

[6] p. 199.

This table does not, of course, attempt to show just what rate of decrease in number of sales would result from the assumed increase in price. In practice the decrease would vary with different commodities and with the same commodity at different times. Moreover, in actual business the variable expenses per unit would not be constant, as it frequently happens that the larger the amount produced the less the expense of production per unit. Neither of these features of the example, however, is at all inconsistent with the principles which it is intended to illustrate

> nopolist has such control over the production that he can control the supply, he will cut off production at 2,500,000 units, at which point demand will fix a price of six cents, and will give the largest net return, viz., $25,000."[7]

The term "monopoly" as commonly employed often lacks that precision of definition which scientific analysis would require, yet its meaning is fairly clear. It is intended to designate a condition in which those who sell have such control over the supply of their commodities that they are able to fix the prices at which the commodities are sold. As stated in the treatise from which the above illustration is taken:

> "Monopoly means that substantial unity of action on the part of one or more persons engaged in some kind of business which gives exclusive control, more particularly, although not solely, with respect to price."[8]

It is recognized that monopoly is not always complete and absolute. The definition refers to "a perfect type of monopoly," whereas, just as in the case of competitive price, competition may not be perfectly free, so, in the case of monopoly price, monopoly may be incomplete.

> "We have a partial monopoly where there is a unified control over a considerable portion of the industrial field, but not over a sufficient portion to give complete domination of the whole field."[9]

Nevertheless, and this is the important fact, whether competition is free or limited, and monopoly complete or incomplete, *the fields of competition and monopoly are considered to be distinct.*

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[7] p. 200. [8] p. 188. [9] p. 191.

> "Our conclusion, then, may be stated as follows: There is a great and growing field of industry in which competition is not natural or permanently possible, for reasons explained in the text; there is another field within which monopoly does not and can not exist."[10]

The main points in the current theory of price may be thus summarized:

1. There are two sorts of price, competitive and monopoly, each of which is determined in accordance with a principle peculiar to it and quite unlike that in accordance with which the other is determined.

2. The essential condition of competition is fluidity, i. e., transferability, of capital, labor, and business ability from one industry to another.

3. Price under competition is determined by social cost of production, for, on the one hand, if price rises above this, profits will rise above the normal, others will be attracted into the industry, production will be increased, and price will fall; while, on the other hand, if price falls below social cost, profits will fall below the normal, some will leave the industry, production will be decreased, and price will rise.

4. The essential condition of monopoly is such unity of action on the part of sellers as gives them exclusive control over price.

5. Price under monopoly is determined by the point that will yield the largest net returns. If, on the one hand, price rises above this point, the loss from the resulting decrease in sales will more than offset the gain from the accompanying increase in the rate of profit; while, on the other hand, if price falls below this point, the loss from the resulting decrease in the rate of profit more than offsets the gain from the accompanying increase in sales. In either case net profits are reduced.

[10] Ely, p. 196.

The practical teaching of this theory of price is apparent: Except in the distinct field where monopoly is natural, make competition free and there will follow normal profits and, by consequence, fair price. Is the theory valid?

III

HOW PRICES ARE DETERMINED

In examining the current theory of price with a view to determining whether its explanation is correct and satisfactory, we will begin with an analysis and comparison of the influences that determine competitive price and monopoly price respectively.

It will be observed that in showing that competitive price tends to equal social cost of production, the method employed is to show that price under the competitive conditions assumed will not permanently remain above or below social cost. In like manner, the method employed to prove that monopoly price tends to the point of largest returns is to show that price under the monopolistic conditions assumed will not permanently remain above or below that point. It will facilitate a comparison of the principles according to which each of these two kinds of price is determined, to bring together for comparison, first, the influences which prevent each from permanently remaining above the points stated, and then the influences which prevent each from remaining below the respective points.

Turning, first, to competitive price, it may be asked: Why does competitive price not rise above social cost? The many forms in which the answer to this query might be put are reducible to one, viz., because of competition. Thus, if shoes are being produced under so-called com-

petitive conditions and $4 per pair yields to the producer a fair profit, the price of these shoes can not permanently remain above $4. For a time, it is true, before conditions can readjust themselves, a seller may be able to get $4.50 per pair, but as this yields more than a normal profit, others will be drawn to the shoe industry and competition will cause the price to fall until it reaches $4.

On the other hand, to the question, Why does monopoly price not rise higher than it does? the answer given is: Because if it did, net profits would be less owing to a falling off in sales for which the increased rate of profit per unit would not compensate. Thus, if for any reason monopoly should come to exist in the production of shoes, those in the monopoly would no longer be deterred from raising the price above $4 per pair by fear of competition with other shoe manufacturers. They would, therefore, raise the price until the decrease in sales would lessen net profits.

This explanation is usually considered wholly adequate to account for the limit to the tendency of monopoly price upward. It is undoubtedly correct *as far as it goes*. But does it go far enough? Does this enable us to compare the influence that keeps monopoly price from going higher with the influence that keeps competitive price from going higher? In the case of the sale of shoes under competition, the seller can not get more than $4 per pair because if he asks $4.50, the would-be purchaser will go to another dealer, and these two sellers of shoes are said to be competitors because they are rivals in seeking the patronage of purchasers, each trying to attract customers by offering a better inducement than his rival in the shape of a lower price.

When it is said that monopoly price is kept from going higher because of the loss in net profits that would

result from the falling off in sales, it becomes important to inquire why there would be a falling off in sales. Why, in the illustration given[1] of the method of determining monopoly price, are but 1,800,000 sold yielding $126,000 when the price is 7 cents, while 2,500,000 are sold for $150,000 when the price is 6 cents? What becomes of the $24,000 that is not spent for this commodity, when the price is raised to 7 cents? To these questions the manifest answer is: When the price is raised from 6 to 7 cents, purchasing power to the extent of $24,000 is diverted into other channels. It goes for the purchase of other commodities which are preferred to this commodity at a price of 7 cents.

This fact suggests another query: What relation do the sellers of the other commodities sustain to those who sell the commodity assumed in the illustration? Here, again, the answer is clear: They are rivals for the patronage of purchasers; that is to say, *they are competitors*. True, competitors are often spoken of as though they were necessarily rivals in the same business. A moment's consideration, however, should suffice to show that as business phenomena, there is no difference *in kind* between the rivalry of those selling the same sort of goods and the rivalry of those selling different sorts of goods, so long as the rivalry results from the fact that each is trying to offer such attractive inducements as to lead people to buy his wares rather than the wares of the same or different sorts offered by others. The extent and force of competition in the business world are but faintly appreciated by those who limit their concept of competition to rivalry between those in the same kind of business. As has so truly been said by Professor Ely:

[1] See above p. 17.

> "The competition of the market embraces not only the buying and selling of a given commodity (like wood), but also the buying and selling of *all commodities. In this sense the wood dealers compete with the grocers and the tailors, as well as with coal dealers and with each other.*"[2]

There is undoubtedly a difference between the rivalry of those who sell like commodities and the rivalry of those who seel unlike commodities. But this difference does not lie in the fact that one is competition and the other is not competition. Rivalry between those who sell like commodities is probably, as a rule, more intense than that between sellers of unlike commodities, but this is a difference in degree, not in kind. This does not mean that the difference is unimportant. The very fact that in some instances the competition that exists is too feeble to stop the upward tendency in price at the point which suffices for fair profits, may justify steps to supplement such inadequate competition. But the fact remains, and its ultimate consequence is by no means slight, that it is competition that prevents price from going higher both in the case of competitive price and in the case of monopoly price. In the ultimate analysis, the statement that monopoly price is determined by the point that will yield the largest net returns means only, so far as the upward tendency of monopoly price is concerned, that it is determined by the point which *under the existing condition of competition* will yield the largest net returns. And it is equally true of competitive price that it, too, is determined in its upward tendency by the point which under the existing condition of competition will yield the largest net returns. This point in the case of monopoly price may be much above the point in the

[2] *Outlines of Economics*, p. 163. Not italicized in the original.

case of competitive price; but this is not due to the fact that different kinds of influences set the limits. It is due, rather, to the fact that competition works in each of the two cases with differing effectiveness.

Taking up next the influences which keep competitive and monopoly price from going below certain points, it will be recalled that current theory teaches that competitive price does not permanently remain below social cost of production, and that monopoly price is maintained up to the point of maximum returns. The first question to be considered here is: Why can monopoly price be kept up to the point specified? Whatever may be the forms which the answers to this query take, they will amount practically to this,—because of the existence of "substantial unity of action on the part of" the person or persons engaged in the business, a unity of action which results in control over the supply of that which the purchaser seeks to obtain. The monopolist, it is said, "freed from competition, and governed only by demand, is able to adjust supply to demand in such a way that the price will stand at the point of highest net return."[8]

On the other hand, when competitive price is under consideration, the reason assigned for its maintenance at social cost of production is that if price falls below this, some will go out of business, production will be decreased, and price will go up. This answer is not satisfactory because it involves the implication that price has within itself some spontaneous force such that, once influences holding it down are removed, price will of its own accord *go* up. Price does not *go* up; it is *put* up. If, in the case of the shoes mentioned above, competition among the sellers results in the price being reduced to

[8] Ely, p. 198.

$3 a pair,—$4 being assumed necessary to normal profits, —it may be expected that in time some will go from the manufacture of shoes to other fields where at least normal profits can be realized. But this fact, even if it results in the manufacture of fewer shoes, is not sufficient to account for the restoration of the price of shoes to its former so-called competitive figure, $4. So long as two producers remain in the field *and continue to compete*, price will continue to fall. Nor is this fact controverted by the truth that producers can not continue indefinitely to produce at a loss. The significance of this lies, not in controverting the proposition that if producers continue to compete, price will continue to fall, but in the fact that producers can not continue to compete indefinitely.

Furthermore, the mere cessation of competition is not of itself sufficient to explain the restoration of price to $4, which may be called its normal point, and this for the reason just given, that price does not move automatically. If competition drives price below cost of production, price will move up, as has been said, only when it is put up, and *it will be put up only when there is such "substantial unity of action" among those remaining in the business as to give a control over supply* sufficient at least to enable them to bring the price back again to its normal point.

It is important to distinguish here between the fact of "substantial unity of action on the part of one or more persons engaged in" a business, and the method employed to secure such unity of action,—a distinction fundamental to this analysis, but often overlooked. When competition drives price below cost of production, "unity of action" may follow merely because one person is stronger than his competitors and is thereby enabled to hold out

until they are driven into bankruptcy, leaving him a free field; or it may result from the purchase by one of the interests of the others; or, again, it may arise from an agreement between the competitors,—assuming the absence of a law to the contrary,—by which they contract not only to suspend competition, but also to unite in raising the price; or, finally, the substantial unity of action, without which price can not be put up, may come to exist without bankruptcy, purchase, or agreement, but merely as the result of an independent recognition by each that he is a loser from unreasonable competition and will be a gainer by spontaneously acting in union with the others. The permanence and efficiency of a unity of action that rests merely upon such a spontaneous recognition of mutuality of interests will be less than when that unity has for its basis an agreement or the elimination of one's competitors, but as a business phenomenon, unity of action is unity of action regardless of how it is brought about or of its effectiveness. Moreover, it is this unity of action and not competition which is responsible for the maintenance of price up to social cost when it is so maintained.

One other explanation of the return of competitive price to social cost calls for brief attention in passing. Some have ascribed this to competition among buyers. According to this view, competition among sellers keeps price down to social cost and competition among buyers keeps price up to social cost. Such a method of reasoning is nothing short of casuistical jugglery, worthy alone of the modern prestidigitator, for if this is an adequate explanation, we are forced to the conclusion that competition is everything and explains monopoly price as well as competitive price. The necessity of such a conclusion is apparent. If the return of price to social

cost, after it has fallen below that point, is to be explained by the competition among buyers which arises when, owing to the low price, supply is decreased, an analogous and equally valid explanation is to be found in the case of monopoly price. It may be said that monopoly price is kept up to its high point by the competition among buyers which arises when the monopolist decreases the supply which he offers on the market. According to this method of analysis, it is, then, competition among buyers that keeps both competitive price up to the point of social cost and monopoly price up to the point of largest returns. Add this to the fact already shown, viz., that it is competition which keeps competitive price down to the point of social cost and monopoly price down to the point of largest returns, and the conclusion follows, as was said, that all price, monopoly as well as competitive, is determined by competition.

As a matter of fact, in so far as competition and unity of action are opposing influences in their effect on price, a valid analysis of price must begin by determining whether these influences are to be viewed as they appear in the acts of sellers or as they appear in the acts of buyers. Whichever standpoint may be adopted, logical consistency requires that it be retained throughout the analysis. In the present case competition and unity of action are viewed as the acts of sellers, because this seems the most common way of looking at them. Such, for example, is the case when competition is regarded as the safeguard of society against extortionate price to consumers. The competition here meant is clearly competition among sellers. Similarly, when monopoly is said to lead to exhorbitant prices, the monopoly thought of is a monopoly on the part of sellers.

From the standpoint of the sellers, then, it is substantial unity of action on their part which is responsible for keeping price up to social cost, when it is so kept up. But, as was seen, it is also substantial unity of action which enables the monopolist to keep price up to the point of highest net returns. Moreover, *the unity of action which is effective in the case of competitive price is a phenomenon in no whit different in kind from the unity of action which is effective in the case of monopoly price. Such difference as exists is wholly one of degree.*

Lest the point here made should be misinterpreted, it may be permitted to repeat what was said in a similar connection in describing the relation of competition to competitive and monopoly price. The fact that it is the same influence which keeps both competitive price and monopoly price from going lower, the difference being one of degree, not of kind, does not warrant the conclusion that the difference is unimportant. Were unity of action to cease from further influence in increasing price when it sufficed to insure the producer a fair return, there would be no trust problem. It is, then, precisely because unity of action, which is necessary and useful to a degree, may and does go beyond the point of necessity and usefulness, that the monopoly problem exists.

Nevertheless, here as formerly the fact remains and is of practical moment, that it is unity of action on the part of sellers, involving a degree of control over supply, which is responsible for keeping price up, both in the case of monopoly price and in the case of competitive price. Putting this conclusion along with the similar one reached from an analysis of the reason why price does not go higher, it will be seen that current theory errs in two important respects: neither competitive price nor

monopoly price is determined by one influence alone; nor do the influences which determine the one differ in kind from those which determine the other. Both are determined by the combined working (1) of competition and (2) of unity of action. When the former predominates, price falls; when the latter predominates, price rises; the actual price in any given case is the resultant of the two.

Two other important modifications of current theory follow as corollaries from the above analysis. First, as to the concept of monopoly. It is customary to define monopoly as such unity of action as gives the seller exclusive control over price.[4] It is to be assumed that the price referred to here is the price at which commodities are actually sold, and not merely the price at which they are offered for sale. But, in fact, the seller practically never has such exclusive control over price; the buyer always has something to say about the price at which a thing is sold, because he determines whether he will accept the terms offered or will go elsewhere, if not for the same kind of commodity, then for some other commodity. Competition in some degree is present.

This does not, however, dispose of the monopoly question, for the degree of control exercised by sellers may be so excessive as to work most serious injury. While, however, the rejection, as unsound, of the concept of absolute monopoly does not dispose of the monopoly problem, it does have a most important bearing upon the direction in which a rational solution of that problem is to be sought.

[4] A frequent cause of confusion in discussions of monopoly is found in the failure to distinguish between "control over a commodity" and "control over the price at which a commodity is sold." As was seen above (p. 18), Professor Ely regards control over price as the distinguishing characteristic of monopoly. After formulating his definition with much care, he says "Price is essential, and must be regarded as the fundamental test of monopoly." *Outlines of Economics*, p. 188.

The other modification of current theory to which reference was made has to do with its teaching as to the condition essential to the existence of free competition. As was seen, it is usually taken for granted that perfect fluidity of capital, labor, and business ability would result in free competition. As a matter of fact, such is not the case. What would result if there were perfect fluidity is that competition would continue until the fair, normal profits of producers were threatened. At this point competition would tend to cease and unity of action would predominate over competition, restoring profits to their normal amount, and, perhaps, threatening, in turn, to make profits excessive, in which case there would be a renewed preponderance of competition. Current theory, then, is correct in teaching that under perfect fluidity of capital, labor, and business ability, price would equal social cost of production, but it errs in assigning as the reason for this the existence of free competition. It is due, rather, to the fact that under such perfect fluidity, the relation of competition and of unity of action would involve a balance at the point of social cost.

IV

A TRUST POLICY FAIR TO BIG BUSINESS AND TO THE CONSUMER

THIS analysis of price and of the nature and working of the influences that determine price has, as already stated, some important bearings on the trust problem.

In the first place, the conclusions reached concerning price show that the proposition that all contracts and agreements which limit competition necessarily restrain trade, is indefensible, at least as far as trade in the long run is concerned. For, not to limit competition at the point where its further action will result in loss to producers means the ultimate bankruptcy of all but the strongest. And when this point is reached, competition is eliminated and trade restrained to a far greater degree than when there are several producers still in the field, even though they work together under some sort of an agreement.

It may be admitted that the immediate effect of lessening competition is to restrain trade, for competition means lowered prices and lowered prices mean, as a rule, larger sales. So, even the competition that brings actual loss to the competitors will lead to larger trade, but only temporarily. When such competition has worked out its inevitable result, it necessarily eliminates itself, and the result is loss to all. It is a truism, that the interests of the consumer quite as much as the interests of the

producer call for fair profits to the latter. The so-called "rule of reason" as applied to the interpretation of the Anti-Trust law in the recent decisions of the Supreme Court in so far as it involves the principle that not all acts interfering with competition, but only such as unreasonably interfere with competition, restrain trade, is unquestionably sound. It is by no means improbable that if this view had been taken in the early interpretations of the Anti-Trust law, industrial consolidation would have developed at a much more moderate pace and the trust problem would be less acute.

A second point suggested by the analysis of price concerns the so-called "natural laws of competition," referred to in the Northern Securities case and not infrequently in the general discussion of the monopoly question. What are these "natural laws of competition" whose unimpeded operation conduces to public advantage? One might suppose, from the common use of the term, that there are certain well-known laws of competition natural to industry somewhat as there is a law of gravitation natural to the physical world. Especially is such an assumption warranted when, without stating these natural laws of competition, they are referred to, not incidentally, but as fundamental to the interpretation of a most important Federal law by the Supreme Court. But search for these laws is vain. No treatise on law or economics supplies them. They have never been formulated. They do not exist. As a matter of fact, the expression, "natural laws of competition," is but a method of referring to the widespread but largely unanalyzed opinion that "competition is the life of trade." Such crude concepts will no more suffice as the basis of a policy that is to govern the business of to-day than untested steel suffices as a basis of the vast engineering

works of modern industry. When subjected to analysis, as has been shown, the natural results of competition, if left to itself, are its own destruction and public injury.

As was noted at the outset, the present trust policy seeks to eliminate certain forms of industry to the end that the field may be left to free competition, in the belief that free competition will insure fair price. Reference has also been made to the fact that up to the present, that policy has failed signally to accomplish the results expected. The measures thus far adopted have not secured the unimpeded working of competition. Not that these efforts have been wholly fruitless, but that the consensus of opinion is that an effective solution of the trust problem has not yet been enacted into law.

Various reasons for this failure are assigned and correspondingly various remedies are proposed. Their detailed consideration need not be entered upon here. The point that calls for emphasis in this connection is that, if the above criticism of the current views of price is valid, the measures already adopted were foredoomed to failure, as will be all other measures which rest upon the same basis. And for this reason: Granting that social cost of production, i. e., the expense of production to the individual plus a reasonable profit, is the correct standard of a fair price, this standard can not be reached through competition alone. *The indispensable requisite for securing a fair price is to secure the proper balancing of competition and of unity of action, the former insuring fairness to the consumer, the latter insuring fairness to the producer.* Whatever may be the details of the policy when they are worked out, this is its starting point, and the sooner it is recognized, the sooner may we expect to discover the specific measures necessary to a rational and effective policy.

Given this as the basic consideration, the next step will be to determine the method by which the desired balance of competition and unity of action can be secured. As shown above, under a condition of perfect fluidity of capital, labor, and business ability, the balancing of these two opposing influences would be automatic. On the one hand, if consumers were called upon to pay too much, the exceptional profits afforded by the high price would attract other producers, and competition would compel a lower price; on the other hand, if producers failed to secure a fair return in any field, such changes among producers would take place as would result in the unity of action necessary to force price up to the point of fairness.

But capital, labor, and business ability are not perfectly fluid. This fact is recognized in the current theory of price, but the method of meeting it involves a serious omission in that theory and a fatal flaw in the policy based upon it. It will be recalled that according to this theory[5] not all capital, all labor, and all business ability need be fluid to secure fair price. The existence of some free capital, some free labor, and some free business ability seeking a field for operation is considered sufficient. But is it? To what extent may fairness be expected from the fluidity of that portion of capital, labor, and business ability not yet employed in industry? Manifestly, the fairness insured by this is fairness to the consumer and to the consumer only. It is the prevention of high prices, i. e., the conservation of the interests of the purchasers alone, that can be expected from this partial fluidity. What, meanwhile, of fairness to the producer?

It is a striking and an important feature of the present industrial policy and of the public opinion back

[5] See above, p. 15.

of it, that the consumers' interests alone are thought to demand special consideration. It seems to be assumed that the producer can take care of himself. If the matter ever enters the mind, it is probably dismissed with the thought: What need of protection has the modern trust whose resources are to be reckoned in millions? Whereas, the very magnitude of the interests at stake intensify the necessity of adequate means for their safeguarding.

Furthermore, the efforts in behalf of consumers have often led to measures denying to producers the only means by which they can defend themselves, viz., an effective unity of action. In defense of such a policy may be urged the danger of the abuse of the power which unity of action gives, if it is permitted to exist. This danger is a very real one, and herein lies the crux of the problem: How can the interests of the consumers be conserved while allowing to producers the unity of action which is indispensable to them? On the one hand is the trite but true fact that unrestrained freedom to combine is intolerable. But, on the other hand, is the equally true fact which, whether trite or not, can not be too strongly emphasized, that no policy looking to fairness can be expected to succeed which does not provide fairness for the producer as well as for the consumer.

While it is true that perfect fluidity of industrial agencies does not exist and has never existed, this fact has not always been as serious a handicap as now, to the attainment of a fair price through the spontaneous working of business influences. During the early part of the nineteenth century, when the idea was taking shape that competition is adequate to the regulation of general industry, if only it can be allowed free play, the character of business favored the so-called "let alone"

or self-abnegation policy. Though it was equally true then as now that fair price is the result, not of competition alone, but of competition and unity of action cooperating, the failure to recognize this fact and the consequent glorification of competition was not a serious mater. Among the features of the industry of that time which favored the "let alone" policy were the small size of business units, their varied character, the relatively small part played by capital and especially by fixed capital, and the individual or partnership form of organization.

When industries were small and markets correspondingly limited, competition among producers was not so intense as now. Moreover, there was frequently a personal relation between producer and consumer which conduced to mutual fairness. The impersonal modern corporation was then the exception. Again, the fact that each industry as a rule supplied a variety of products tended to soften the effect of an excessive competition in the case of some articles, as the seller might make up for unduly low profits on them by correspondingly high profits on others. The relatively small part played by capital signified a larger fluidity of business ability. Under such conditions it was easier for one to leave an unprofitable field and betake himself to a profitable one,—a transfer which was rendered easier then than now, too, by the relatively small amount of fixed capital required in industries. In short, business ability and capital,—and for that matter, labor also, which had not yet become intensely specialized,—were highly fluid, and even where fluidity was lacking, conditions existed which tended to prevent unfairness.

The contrast between the character of business at the beginning of the nineteenth century and its present